SEARCHING FOR FAIRNESS

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INTRODUCTION

Nobody likes paying taxes.

But we all know some taxes are necessary. Without them we wouldn't have roads, parks, airports, or water and sewage facilities.

We wouldn't have police or firefighters, or garbage-collectors.

We wouldn't have medicare, public education or programs to help poor families with children.

Without taxes, we wouldn't have any of the public services and programs that make a society liveable.

"I don't mind paying taxes," a famous jurist once remarked. "They buy me civilization."

Why, then, are so many of us dissatisfied with the present tax system? Why do so many of us object to paying the bills for the services our various levels of government provide–even though we agree they're important?

The answer we get from the people we talk with, and from polls and surveys, is that a large number of us believe we're being overtaxed. Many of us don't trust politicians to spend our tax dollars wisely. We suspect there's a great deal of waste in government spending. We also question whether everyone is paying their fair share.

These doubts about the fairness of the tax system may explain why so many of us are doing all we can to avoid paying taxes. Some of us have even joined in the "tax revolts" that have erupted in many communities.

But some of us are starting to ask some probing questions. It is a fact that some individuals and profitable companies pay little or no income tax. But why? What are the rules and regulations that allow them to do so? And what about the people who work outside the tax system entirely, in the so-called "underground economy"?

People are also challenging the extent of taxation, wondering if governments are relying too much on taxes like the Goods and Services Tax (GST) and the provincial Retail Sales Tax. There's also some concern that high taxes are making it difficult for Ontario manufacturers and retailers to compete with companies outside the province.

The Ontario Fair Tax Commission was established to respond to these and other questions. Its mission is to advise the government by the fall of 1993 on how the provincial tax system can be made more fair.

You may wonder if this exercise in tax reform will be any more successful than previous attempts. There may be skepticism about the government's willingness to act on the commission's recommendations.

There are good reasons, however, to view the Fair Tax Commission (FTC) with some degree of hope and optimism.

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Why? First of all, because the commission is comprised of people from all walks of life. Second, because the FTC will be talking with and listening to a variety of people, including the "tax technicians" – the lawyers, accountants, economists and the specialists who work in the public service. But it will also be reaching out farther into other communities. Its mandate calls for the widest possible consultation with the widest range of taxpayers, particularly those who haven't had the opportunity to participate in previous discussions about tax policy.

The FTC is committed to listening to people. And the government, for its part, is committed to listening to the FTC.

That's why the FTC is inviting comments and ideas from everyone who wishes to submit them.

That's why the FTC's public hearings will be open to any individual or organization with anything to say about the taxes we pay.

All of us possess values that contribute to our sense of what's fair. And these values are important when considering the design of a fair tax system. But to get involved constructively in the tax reform process, you must have some understanding of how the tax system operates. You don't have to become a tax specialist, but you should know the basics.

This is not as difficult as it may seem. We don't have to wade through the tax laws and learn all the legalistic jargon. But it is important to know, for example, how to distinguish among federal, provincial and municipal taxes; and roughly how much money each tax generates. It also helps to know what's meant by some of the more common terms, such as exemptions, credits and deductions. *(See glossary on page 29.)*

So there's a need to do a bit of homework before you can help the commission address the issues the government has asked it to tackle.

The Federal Royal Commission on Taxation (the Carter Commission) put primary emphasis on fairness in its 1966 recommendations for tax reform.

Its approach to fairness was largely based on ability to pay, regardless of the source of a taxpayer's income. All income should be taxed in the same way, as summed up in Kenneth Carter's most oft-quoted statement: "A buck is a buck is a buck."

The Carter Commission defined a fair tax system as one in which a taxpayer's overall tax burden would be related to his or her income level, and in which all taxpayers in the same financial circumstances would pay the same amount of tax.

They are issues that cover the whole spectrum of tax fairness. For example:

- Are there too many different kinds of taxes? Can they be combined and simplified?
- Should more or less tax revenue come from a tax on income; on consumption; on property; on wealth? Should the present "tax mix" be revised? How?
- Should Ontario introduce a wealth tax? A minimum tax on corporations?
- Are Ontario's low-income families getting enough tax relief? Too much?
- Should the government have a process in place to reevaluate the tax deductions and subsidies available to taxpayers?
- Would there be any benefits to taxpayers if Ontario merged its retail sales tax with the federal GST?
- Should education continue to be financed mainly from property taxes?
- Have the property taxes that fund municipalities and school boards risen too far, too fast, relative to inflation? And relative to the services now being offered taxpayers?
- If making the tax system fairer meant higher taxes for some companies and individuals, is there a concern they might move to other places where they'll pay less tax?
- And what about the relationship of taxes to women and to the poor? Does the tax system discriminate against these groups?

To come up with workable proposals on these and other important tax matters, the commissioners and the FTC's eight working groups need your input. As the person who pays the taxes, you should be heard. The commission has been established to give you the opportunity.

This booklet is designed to provide some of the information you need to discuss these and other questions. Together with other leaflets, newsletters and information-sheets available from the commission, the following pages – written in non-technical language – help explain what Ontario's tax system is all about and raise some of the tax issues currently the subject of debate in our province.

After reading this booklet you'll be better equipped to take part in the commission's work. What's more, you'll be able to do so confident that your recommendations for tax reform will be as well founded as they are welcome.

• WHO COLLECTS TAXES •

Taxes are collected from us by all levels of government - federal, provincial and municipal.

In 1989, more than $200 billion of tax revenue was raised in Canada, of that about 54% went to the federal government.

The federal government is responsible for major national programs and services, such as defence, family allowances, and transfer payments to provinces including Ontario.

The provinces can only tax within their own boundaries. That is, in Ontario, only those who live in or operate businesses in the province can be taxed. As well, all those who purchase either goods or services in Ontario are subject to sales tax.

The municipalities get their taxing power from the province, which normally limits them to property tax revenue, along with a few miscellaneous sources such as amusement taxes, licences, user fees and permits.

Ontario needs more money than other provinces to provide services to its larger population - and of course, has more taxpayers to collect it from. Ontario's estimated total tax revenue for the fiscal year 1990-91 was about $38 billion, accounting for about 17% of all tax money raised in Canada that year. (On a per capita basis, however, Ontario's tax levels compare favourably with those of most other provinces.)

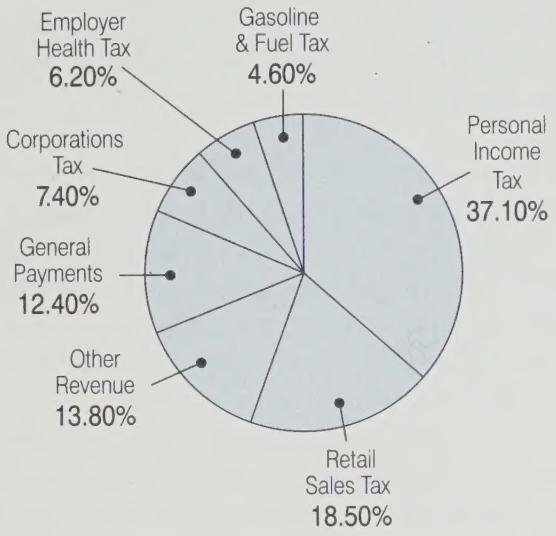
The three largest sources of tax revenue for the Ontario government are the personal income tax, the retail sales tax, and the corporate income tax, in that order. Together they make up roughly 70% of the tax revenue raised by the province. The other 30% comes from a variety of "specialized" taxes, such as those imposed on tobacco, alcohol and gasoline.

Those who own homes and businesses (and, indirectly, those who rent) also pay another $12 billion or more annually in property taxes to our municipal governments and school boards, but this money is spent only for local services and schools. If we count the property tax as a provincial tax, it actually ranks second in importance, after personal income tax.

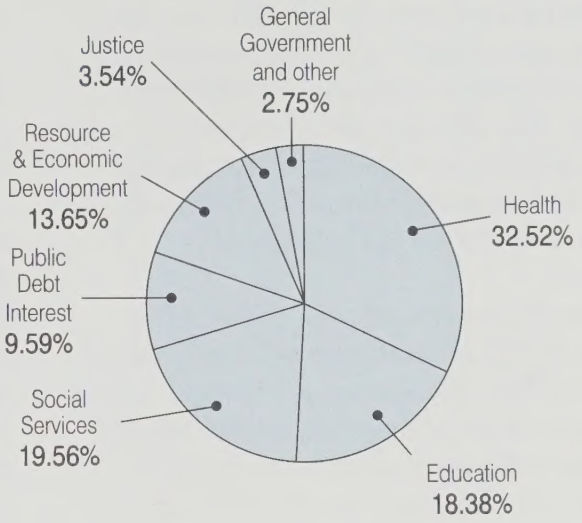
Like other provinces, Ontario receives funds from the federal government that go into a general revenue fund. Some of this money is used to help cover the costs of medicare, post-secondary education and social services. But these funds have been capped. As a result, the provinces can't rely on them to even maintain the existing programs at the current level, let alone cover the rise in the costs of these services. In the 1991-92 fiscal year, transfer payments from the federal government made up just 12% of the province's total revenue from all sources.

Now let's look more closely at each of the taxes collected in Ontario. We'll see how they are applied, and how they fit into the overall tax system.

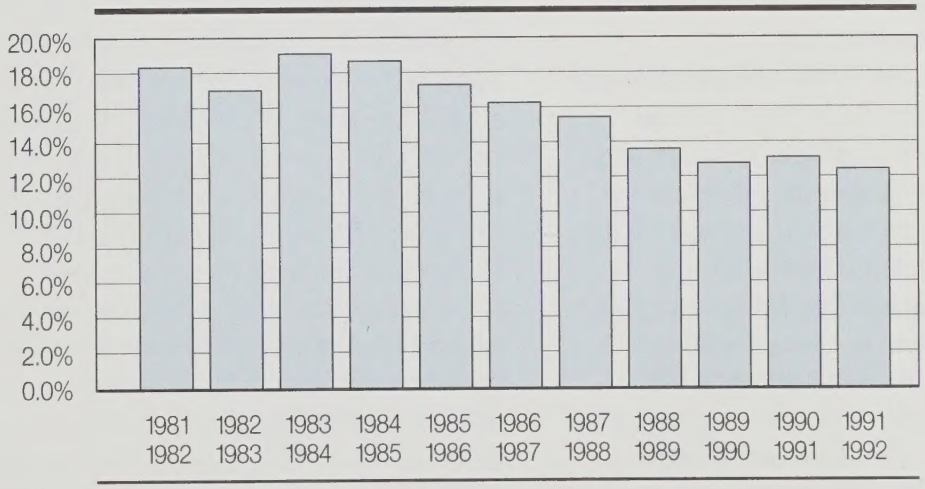
DISTRIBUTION OF ONTARIO GOVERNMENT REVENUE FOR 1991/92, BY TYPE



DISTRIBUTION OF GOVERNMENT EXPENDITURES FOR 1991/92, BY PROGRAM AREA



TRANSFERS FROM THE FEDERAL GOVERNMENT AS A PERCENTAGE OF PROVINCIAL REVENUE



THE PERSONAL INCOME TAX

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In 1988, approximately 5,000,000 Ontarians paid provincial income taxes. The personal income tax is the largest single source of revenue for the province, currently raising about $16 billion or more than 40% of the province's tax revenue. Ontario doesn't collect this tax itself. Ontario's income tax is actually collected by the federal government under the Tax Collection Agreement.

Under this agreement, your Ontario tax is currently 53% of the basic federal tax you pay. In addition, in 1992, a high-income provincial surtax is applied at 14% of the Ontario tax over $10,000. This surtax will usually apply to those with taxable incomes of more than $84,000. Tax credits on property and sales tax reduce the tax burden on low-income taxpayers. (There are two additional tax credits for political contributions and home ownership saving).

Beyond these provisions, however, Ontario is bound by the agreement to use federal definitions of income, deductions and most credits, and income tax brackets.

As you will see, some of the identified issues in provincial tax reform can be dealt with by Ontario under the current system. In other areas, changes in either federal income tax law or the tax collection agreements would be required if Ontario wanted to implement reforms. For example, important issues like the tax treatment of investment income as compared with the treatment of income from employment, the deduction of contributions to pension plans and RRSPs, and the basic tax rate structure are currently determined at the federal level.

When discussing the personal income tax system, it is important to note the distinction between tax credits and tax deductions. Both are used to reduce the amount of tax a taxpayer pays, but there is a subtle and important difference.

A tax credit is an amount that you deduct from the total tax you owe. It is different from a deduction, which is used to reduce your income before the tax is calculated. Although it doesn't sound like much, the difference is important. Because a tax credit comes directly off the tax you owe, it is worth the same to everyone, regardless of their income. Because a deduction comes off your income before tax is calculated, it is worth more to a taxpayer with a high income who pays tax at a high rate, than it is to a taxpayer with a low income.

There are two different kinds of tax credits – non-refundable and refundable. Non-refundable credits can only be used to reduce your tax to zero. In most cases, if you have more in non-refundable credits than you need to reduce your tax to zero, you don't get any benefit from the additional credit. With refundable credits, you benefit even if you don't pay any tax or if you don't owe enough tax to use up all the credits. The government sends you a cheque for the amount of the credit you haven't used.

Ontario has both kinds of credits. The sales tax and property tax credits are refundable. The political contributions tax credit is not. An estimated 1,600,000 Ontario families with incomes below $25,000 shared refundable tax credits totalling more than $300 million in 1991.

People with earnings as low as $9,000 must still pay income taxes. The majority of these low-income taxpayers are women.

Two-thirds of tax returns with incomes below $5,000 are filed by women. And women make up less than 20% of taxpayers reporting incomes higher than $50,000.

In Canada, the average income of a single-parent family headed by a woman is $22,600. Fifty one per cent of such families are poor.

Does the tax system contribute to this situation? Can the tax system be changed to help to improve the economic status of women in Ontario? These are some of the questions the commission will be addressing and seeking your help in answering, as it carries out its work.

FOR DISCUSSION

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The principle that people with more financial strength should pay proportionally more tax than people with less, is known as progressive taxation. This notion is generally regarded to be fair. Just about every tax reform exercise in the past has at least paid lip service to this principle.

But how progressive is our current system? More important, is a progressive tax system the fairest system?

On the surface, our income tax looks as if it is progressive. The higher your income, the greater the percentage of any additional income you pay in tax. But our tax system contains many special rules for certain kinds of income and many deductions and special credits that are available if you meet restricted qualifications. For example, the tax rules for income from capital (dividends and capital gains) are different from the rules for income from employment.

Even some deductions that appear to be available to everyone raise issues of tax fairness. For example, the deduction for RRSP contributions is biased towards higher income individuals in three ways. First, the greater your income, the more you're allowed to deduct. Similarly, the value of the deduction is higher if you're in a higher tax bracket. Finally, higher income people tend to have more money available to put into RRSPs in the first place.

As a result, some individuals with certain types of income who qualify for special treatment end up paying a smaller share of their income in tax than other people whose income makes them ineligible for the reduction.

Federal tax reform in 1987 helped a bit by changing most deductions to credits. But some people hold the view that it also made the rate structure less progressive by lowering the top tax bracket. Is it fair that the basic marginal tax rates now stop at $60,000? To make the tax system fair, what should be the highest tax bracket?

The Fair Tax Commission is going to be looking at all changes to the tax system that could make the system fairer, regardless of which level of government currently has the authority to make the change. Some changes can be made by Ontario on its own. Others can only be made if the tax collection agreement is amended or if Ontario cancels the agreement and establishes its own income tax collection system. And still others, as a practical matter, could only be made effectively at the national level. The commission will be looking at all options for change.

In 1989, more than 1.4 million patients were admitted to Ontario's 221 hospitals. Almost all medical procedures are covered by publicly funded medicare, paid for with tax dollars.

A TALE OF TWO TAXPAYERS

Mary and Jenny are both single and live in Ontario. Neither has any dependents. Last year, they each earned $50,000.

Mary receives her income as salary. Jenny's earnings came from investments – $10,000 in capital gains, $10,000 in interest and $30,000 in dividends.

Mary pays $14,400 in taxes, $4,800 to the provincial government. Jenny pays a total income tax bill of $5,800, $2,000 of which is paid in provincial taxes. Despite their identical income, Jenny pays $8,600 less in tax than Mary.

The difference between what Jenny pays in tax and what Mary pays can be attributed to the different tax treatment of salary versus other income.

The income Jenny earns from capital gains is taxed differently than the same amount of money earned from a straight salary. The first 25% of capital gains is exempt from tax so taxpayers only pay tax on 75% of capital gains.

Furthermore, until taxpayers exceed the $100,000 lifetime exemption on capital gains, they don't pay any tax on a capital gain.

Jenny has not used any of her lifetime exemption so she does not pay any tax on the $10,000 capital gains she has claimed.

Taxes on dividends are also offset by a tax credit which contributes to the difference in the tax paid by Mary and Jenny.

The capital gains exemption was introduced in 1985 to encourage investment that carries a higher risk. However, some people claim that the capital gains exemption is being used more as a tax shelter than as an enticement to invest.

The reason given for reducing the tax rate on dividend income is that dividends are paid to shareholders by corporations from profits, and corporate profits have already been taxed. This adjustment, however, is not perfect, because dividends qualify for the same tax credit regardless of the actual amount of corporate tax paid (even if it was zero).

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In calculating taxable income in the personal and corporate income tax systems for both provincial and federal taxes, different kinds of income are treated in different ways. Dividends from Canadian corporations, for example, are treated differently from other income because of the way Canada integrates the personal and corporate income tax systems.

Some kinds of windfall gains, like lottery winnings, are completely free of tax. Other gains, such as inheritances, are treated the same. And gains that result from increases in the value of assets are subject to a special set of tax rules, exemptions and rates. Owner occupied dwellings are completely exempt from capital gains tax. In addition, every individual taxpayer is allowed to claim the first $100,000 in capital gains in his or her lifetime tax free. For Canadian-owned small businesses, this exemption is increased to $500,000. Finally, when you receive income in the form of a capital gain, you pay tax on only 75% of the gain. The other 25% is tax free.

This means that a taxpayer who hasn't used up his or her exemption gets any capital gains income tax free. And even after the exemption is used up, 25% of any gain is not taxed.

When capital gains taxation was originally introduced in Canada in the early 1970s, the argument for lower rates was based on the idea that capital gains that merely keep up with inflation should not be taxed; that only "real" gains should be taxed. Rather than try to measure the difference between inflationary gains and real gains, the federal government concluded on a "rough justice" basis that a lower rate was justified. But in doing so, it created a special category of income that is treated more favourably than wage and salary income.

QUESTIONS

At present, a family of four has to have an income below $22,000 before their Ontario tax drops to zero. This compares with the Statistics Canada low-income cut-off of about $25,600, commonly known as the 'poverty line'. Should the low-income cut-off in the tax system be higher?

Should the remaining tax deductions be converted into credits to make sure they're worth the same amount to everyone who claims them, or should some deductions (like the deduction for RRSPs or private pension contributions) be continued?

Does it make sense to be providing social benefits like allowances for children or child care assistance through the tax system, or should these benefits be provided directly through government programs?

What is the link between taxation and individuals being motivated to leave the province or country?

Seniors over 65 receive all prescription drugs free of direct charge courtesy of the provincial government and taxpayers. Last year, more than $667 million was spent on this program.

THE RETAIL SALES TAX

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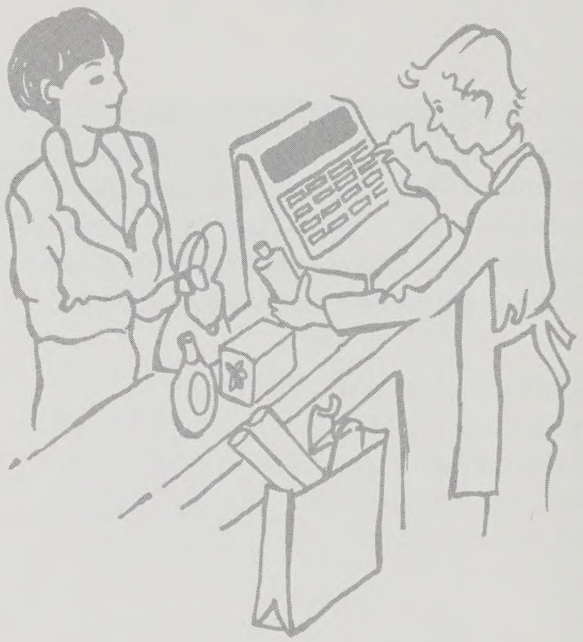
The retail sales tax generated about $8 billion in 1990-91, placing it third behind personal income taxes ($16 billion) and property taxes ($12 billion) among revenue sources controlled by the province. However, it should be noted that the retail sales tax is the largest revenue source entirely under the control of the provincial government for its own needs. This is due to the fact that property taxes are devoted exclusively to services provided by municipal governments and school boards, and authority over personal income taxes is shared with the federal government.

Both consumers and businesses pay retail sales tax when goods (and a limited range of services) are purchased for final consumption. The retail sales tax is a percentage of the retail price of any goods to which it applies. The general rate of 8% applies to most goods with the exception of such things as groceries, children's clothing, prescription drugs and energy used for heating and lighting which aren't taxed at all. Special tax rates (higher and lower than 8%) are applied to some other goods and services including alcohol, hotel accommodation and the purchase of some automobiles.



Ontario's retail sales tax was introduced in 1961 at a rate of 3%. It was raised to 5% in 1966; to 7% in 1973; and to the present level of 8% in 1988. (This general rate has been reduced on occasion in the past in an attempt to stimulate a sluggish economy or stimulate an industry that needed assistance). It is estimated that about 70% of retail sales tax is paid directly by consumers in Ontario, with about 30% being paid by businesses on products and services that they use in the production process (inputs), such as office supplies, furniture and telecommunications equipment.

FOR DISCUSSION:

There has been a lot of talk lately about "integrating" the Ontario retail sales tax with the federal GST. The federal government and a number of business organizations have been urging provinces to implement a single integrated sales tax system. The advantages claimed for such a system are that it is fairer to businesses and that it would be easier for retailers to administer and for consumers to understand.

The fact that the Ontario retail sales tax applies to final consumption by both businesses and consumers means that for some products and services, the percentage of the price paid in tax can actually be much higher than 8%. When you buy a product or taxable service that is manufactured or provided in Ontario, you pay provincial sales tax in two ways. You pay the "up front" tax of 8% at the retail level. But because businesses can pass on the tax they pay on the things they use to produce goods and services (inputs), you may also pay some input taxes that are included in the retail price. This is known as the "cascading" effect of the retail sales tax. As a result, proposals about integration raise many of the same issues that were debated in connection with the federal Goods and Services Tax (the GST).

In particular, businesses that trade across borders argue that the retail sales tax increases their costs in comparison with their competitors in both Ontario (importers into the province) and Ontario's export markets. Taxes like the GST attempt to address this problem by allowing businesses to get credit for the sales taxes they pay on their inputs. If this were done in Ontario, it would ensure that tax is only levied once on taxable goods and services sold in Ontario, thus putting them on an equal footing, or giving them a cost advantage compared with competitors outside the province. This is one reason why Ontario firms are so keen to integrate the Ontario retail sales tax with the GST.

Quebec says that the integration of its sales tax with the GST would cut the cost of business purchases by an average of 3.5% and reduce the average cost of goods exported from Quebec by 1%. Ontario businesses worry that these numbers mean that they will be at a competitive disadvantage compared with Quebec, if Quebec integrates.

On the administrative side, the fact that some goods and services are taxable by Ontario and not by the federal government, while other goods and services are taxable by the federal government and not by Ontario, makes the situation expensive for retailers to administer and confusing for consumers.

Although integration would seem to be an obvious and easy response to this situation, if adopted, there are significant problems that could arise. The biggest issue is how to pay for the savings that are realized by businesses when taxes on their

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inputs are eliminated. The idea behind the change is that savings could be passed on to consumers in the form of lower prices. But a lot of the savings are on inputs into the production of goods and services that are produced in Ontario and consumed elsewhere. This would likely result in increased exports, but consumers can't benefit immediately from those savings. Some people argue that there's no guarantee that even the savings on goods and services consumed in the province will be passed on to Ontario customers.

This means that although there is potential to spur the economy by adopting an integrated federal/provincial sales tax system, if retail sales taxes are taken off business inputs, additional revenue will have to be found somewhere to keep public revenues at the same level. And there are only three possible ways to raise that additional revenue: broaden the sales tax base to include more goods and services; raise the sales tax rate; or increase revenues from some other tax.

There is general agreement that fair tax systems should be based on the ability to pay. But opinion differs when it comes to choosing the most appropriate tax base for personal taxation. How do you measure the ability to pay? There are three main alternatives:

Comprehensive income

As a base for a tax system, this would require that income from all sources be considered taxable. (This was the principal recommendation of the 1966 Carter Commission.)

Consumption

Under a tax system based on consumption, income would only be taxed when it is spent instead of when it is earned or received.

Wealth

A wealth-based personal tax would combine the features of both the income and consumption models, since wealth can be used either to generate income or to support consumption.

All three of these proposed tax bases have their advocates and critics. All have advantages and disadvantages.

It is possible that the best alternative for the province would be a combination of the three.

QUESTIONS:

Should Ontario take the sales tax off business inputs and harmonize the retail sales tax with the GST? Even though it might be seen as support for a federal tax which is very unpopular in Ontario? Even if Quebec doesn't follow through on its plans to integrate?

If Ontario were to take the sales tax off business inputs, how should the province replace the lost revenue? By increasing the tax rate on all goods and services? By increasing other taxes paid by corporations? Is it possible for Ontario to take special steps to ensure that input tax savings are passed on to consumers?

Is it a good idea for governments to be relying more on taxes based on consumption and less on taxes based on income? Is it fair that low-income families have to pay the same rate of tax on goods and services as those who have more money? Does the current strategy of giving credit to low-income earners on personal income tax offset the money spent on sales tax?

Should Ontario consider broadening the provincial sales tax base to include such items as food, energy for home heating and other goods and services?

• THE CORPORATE INCOME TAX •

All corporations doing business in Ontario must pay the provincial corporate income tax, a tax that generally parallels the federal tax.

But there are several reasons why some profitable corporations may pay little or no tax. A portion of their capital gains income is non-taxable. Special deductions for investments in research and development and pollution control equipment allow companies to reduce their taxable income. Corporations can also: (1) carry losses over from other years to deduct from the current year's taxes; (2) receive dividend income without paying tax and; (3) speed up their deductions for capital expenditures, e.g. claim the entire cost of new machinery long before its economically useful life is over.

Ontario's general corporate income tax is set at 15.5% of taxable corporate profits. The rate for manufacturing and processing industries is lower at 14.5%, and the rate for small business, lower still, at 10%.

Ontario's corporations must also pay the federal corporate income tax, which is nearly double the Ontario rate for all types of businesses except small business.

The estimated revenue paid to the Ontario government from corporate tax was $3.17 billion in 1990-91, contributing approximately 8% of the province's tax income. This, however, was a drop of around $600 million from the previous year, because of the economic recession that has stifled business activity in the province in the early 1990s.

One of the problems in trying to make any tax system fairer is that taxes levied on one taxpayer may wind up being paid by another taxpayer.

For example, a tax assessed on a corporation may be:

- passed on to consumers through higher prices;
- passed on to employees through lower wages; or
- absorbed by the corporation's shareholders through lower dividends or reduced capital gains.

Experts in "tax incidence" – the determination of who actually bears the burden of taxes – tell us that all taxes are ultimately paid by individuals in their roles as consumers, employees, or investors.

FOR DISCUSSION:

Special provisions in the tax laws applying to business firms allow some to pay very little or no tax, even though their financial statements show profit for their shareholders.

Since, in the end only people pay taxes, any increase in corporate tax revenue ends up being paid by some individuals. Ultimately corporate taxes may be paid by several groups: by their customers in the form of higher prices; by their employees in the form of lower wages or fewer jobs; or by shareholders (Canadian or foreign), either directly by lowering dividends or indirectly as lower profits reduce share prices.

If we could actually tax all corporate shareholders on their share of the income earned by corporations, there wouldn't be a need for a corporate income tax. However, taxing corporations is an efficient way to ensure that tax is collected on corporate profits. Taxing profits at the corporate level prevents shareholders from deferring payment of tax by leaving profits in the hands of a corporation and provides a way to ensure that foreign shareholders pay tax on the profits they earn from corporations doing business in Ontario.

Our future, and the future of our children, is shaped by the technological, academic and social advancements made today. Last year 20 provincial ministries allocated more than $300 million dollars to research and development projects.

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One of the most often-heard arguments against increasing taxes on corporations is that it would make them less competitive with foreign firms and force them to relocate their operations outside Ontario where the taxes are lower.

Many of the countries that Canada trades with, however, impose higher corporate taxes than we do, including most countries in Western Europe, as well as Japan. Corporate taxes in the United States however, are lower.

Nevertheless, many business people and economists maintain that taxes can and do play a critical role, at the margin, in investment and relocation decisions. They point to the devastating effects of the latest recession as an argument against imposing a higher tax burden on business.

Others argue that tax levels are not a major factor in business location. For most firms, taxes comprise only a small fraction of their overall costs. The costs of real estate, raw materials, labour, energy and transportation all rank higher than taxes in determining where a business will locate, move or expand.

QUESTIONS:

Do you think corporations pay their fair share of income tax?

What about the effect higher corporate taxes might have on the ability of firms to compete with firms in other provinces or countries that don't have high corporate taxes?

If corporations were taxed at higher rates, they might move their operations to locations with lower rates. Are there reasons that corporations might stay regardless of corporate tax increases?

PROPERTY TAXES

The property tax is the second largest source of tax revenue in the province. It now raises nearly $12 billion a year.

One of the main differences between this tax and others is that it is not collected by the provincial government. Instead it is levied by municipalities and school boards, and its revenue is used to cover the costs of local services and local schools.

The province, however, sets most of the conditions under which local governments and school boards collect the property tax. It is the province that controls the tax base (including how taxes are distributed among different types of property); the province that decides the formula by which the value of property is assessed and reassessed; and the province that controls local governments' basic tax policies.

On the other hand, it is the regional and municipal governments, along with the school boards, which set the actual property tax (mill) rate, and decide whether and by how much the rate will be raised each year.

Property in Ontario used to be assessed on the basis of several very complex factors, and in different ways in different municipalities. Now, most properties are taxed on the basis of their market value – the price they would command if put up for sale. (A notable exception is Metro Toronto, where concerns about tax increases on older homes have generated opposition to reassessment based on market value.)

The revenue from the property tax is by far the largest source of income for regional and local governments, and for school boards. However, it falls short of covering all their operating costs. The provincial government provides them with supplementary grants.

FOR DISCUSSION:

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Of all taxes, property tax has sparked the strongest reaction among Ontarians, with the possible exception now of the GST.

This is understandable. It's a large tax, and it's very visible. Unlike the income tax, which for most of us is deducted in relatively painless instalments from our pay-cheques, the property tax has to be paid directly in big chunks out of our bank accounts.

It's also a tax that does not necessarily bear any relationship to the incomes of property owners, or their ability to pay it. Pensioners, for example, may have much lower incomes than they did while working, but they are still assessed the same amount of property tax and have to budget for the same increases as their neighbours who still have income from employment. As well, in some areas, those on fixed incomes like students or young families find it difficult to find affordable housing – property tax increases make the search more difficult.

The same applies to business firms, which face the same taxes regardless of their fluctuating profits and losses from year to year.

Property taxes also affect rental rates, since landlords inevitably pass on the cost to their tenants. However, since the "pass-on" effects are indirect, many renters are not aware of how large a factor the property tax really is in determining how much rent they pay.

School boards now take the largest part of the revenue from property taxes. The funding of education from this form of tax has a long tradition, but some people question the logic (or even fairness) behind it. While basic services are equalized across the province through provincial grants, school boards in wealthy municipalities can afford far more additional services than those in less wealthy areas.

Critics of the market value system of determining the property tax base also complain that it inflates the resale value of some properties compared with their actual value in current use; that it sets widely differing values on similar buildings in different parts of a community; and that it discriminates against those who have no intention of ever selling their homes.

The frequency with which the property tax rate is raised (usually every year, and often by a lot more than the inflation rate) is also a cause of much resentment. Most other taxes stay at the

same rate for at least a few years. Of course, this is because the tax base for most taxes (income tax, sales tax, etc.) goes up continually and, in the process, automatically raises the tax revenue, whereas the property tax base stays the same. So the only way to increase revenue from property tax is to increase the rate. This is little consolation, however, for property owners, who still react negatively to the frequent rate hikes.

Another reason for the escalation of the property tax rate is because of the "downloading" effect of higher levels of government cutting back on their transfer payments. When Ottawa cuts its grants to the province, the province often correspondingly limits its grants to municipalities and school boards, which in turn are forced to tap their main source of income, the owners of property. Property owners have thus tended to become the revenue source of last resort.

In 1990, nearly 2,000,000 school-aged children were learning reading, writing and arithmetic in publicly funded schools in Ontario.

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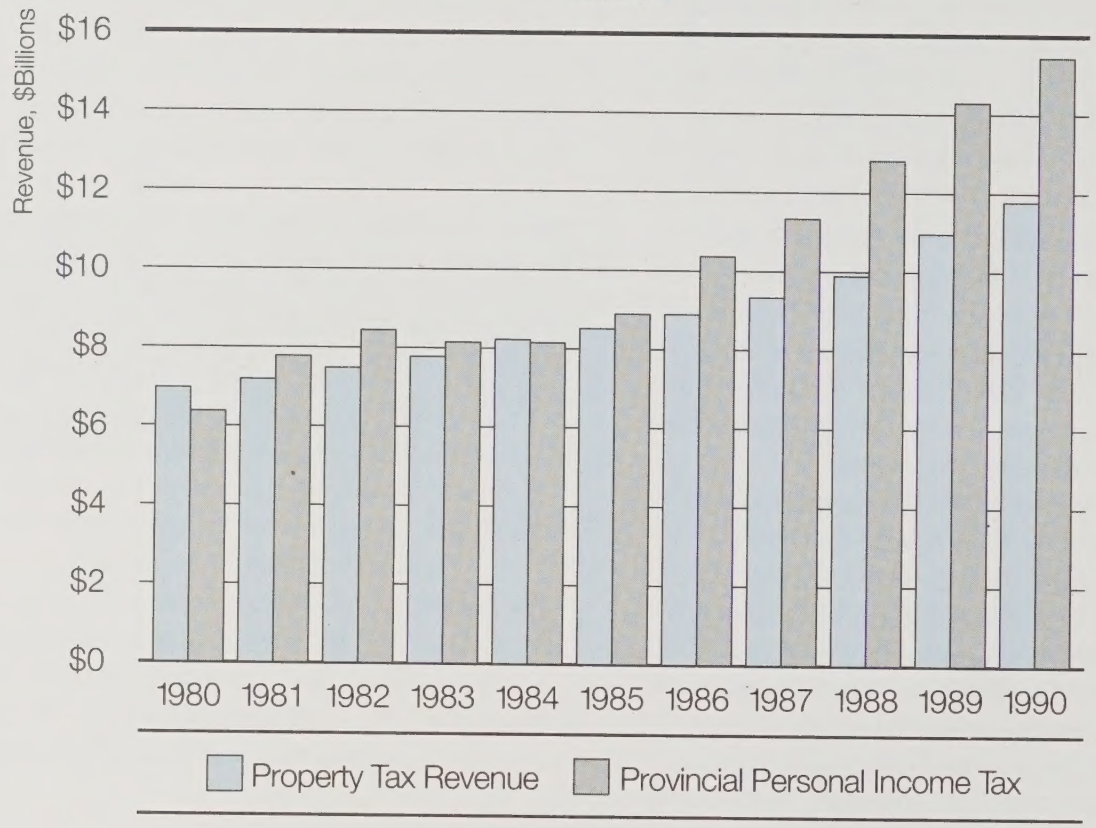
GROWTH OF PROPERTY TAXES IN ONTARIO, 1980-1990
1990 $'s



QUESTIONS:

Do you think the property tax should be maintained in some form, or replaced by another kind of tax that is more closely geared to incomes and ability to pay?

Even if property taxes continue to fund municipal services, should it continue to fund 'soft' services like education and social services, or should these services be funded from other revenue sources?

Should a substitute for the property tax be an "add-on" to the federal/provincial income tax? Or should it be a "user-pay" tax based on the extent to which each household uses or benefits from various municipal and educational services?

If you favour keeping the property tax, how would you suggest making it more fair? By putting limits on rate increases or by changing the market value formula to one based on real assessed value, unit value, or site value? Or through more effective property tax relief measures such as tax deferrals or improved tax credits and grants to lower-income home owners?

Should those who own a cottage be assessed the full amount of property tax on their vacation home, even though they don't have access to some of the services that property taxes pay for such as education?

OTHER TAXES

Capital Tax: This tax is assessed on all corporations in Ontario with total assets or gross revenue in excess of $1 million. (Insurance companies pay a separate tax on their premiums.) The tax is levied on a company's "paid-up" capital assets or financial resources, which include its capital stock, retained earnings and surpluses. The present rate is 0.3% on general corporations, and 0.8% on banks and trust companies. Relief is provided for small businesses. The capital tax raised $606 million in 1990-91, about 1.6% of total provincial tax revenue.

Employer Health Tax: This tax, introduced in 1990 as part of the replacement of OHIP premiums, is set at 1.95% of employees' pay for employers with payrolls of $200,000 or more. For smaller firms, the rate is 0.98%. With an estimated revenue for 1990-91 of $2.6 billion, it's Ontario's fourth largest revenue source.

Gasoline and Diesel Fuel Taxes: These taxes are applied to the purchases of gas and diesel fuel for use in motor vehicles (as well as boats and even lawn-mowers). The tax on gasoline is 11.3¢ a litre, and on diesel fuel 10.9¢ a litre. Similar rates are imposed on propane, railroad diesel, and aviation fuel. Revenues from these fuel taxes amounted to $1.77 billion in 1990-91, accounting for about 4% of total tax revenue.

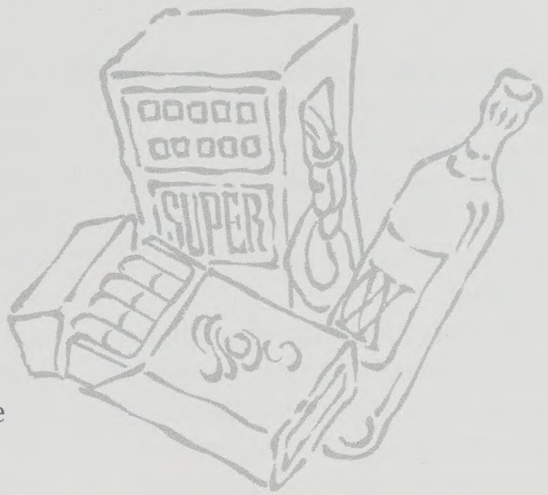
Alcoholic Beverage Tax: A complicated system of charges is applied to the sale of liquor, wine and beer, consisting of flat percentages and levies along with a higher (12%) retail sales tax rate. Revenues in 1990-91 were $1.1 billion, just under 3% of total revenue.

Tobacco Tax: The tax on tobacco (in 1991) was 4.83¢ per cigarette, and 4.83¢ per gram for cut tobacco. Approximately 94% of tobacco tax revenue comes from cigarettes. In addition, of course, tobacco is subject to the 8% provincial sales tax. In 1990-91, the revenue from tobacco taxes was $880 million, or 2.3% of total tax revenue in Ontario.

Land Transfer Tax: This tax is paid when property changes hands and the transaction is registered. Based on the property value, the rates range from 0.5% of the value up to $55,000, to 2% when the value is above $400,000. Estimated revenue for 1990-91 was $460 million. This was a steep drop from the previous year's revenue of $701 million which was caused by the slump in the real estate market.

Mining Tax: This tax is levied on mining operations in Ontario. It applies to gross revenues less deductions for certain costs (e.g. production, processing, transportation,

exploration and development, etc.). The first $500,000 of mining profits is exempt each year, and new mines are also exempt for their first three years of commercial operation. Revenue tends to go up and down due to the cyclical nature of the industry, generating $197 million in 1989, but only $97 million in 1990-91.



Forestry Tax: Applied to companies that harvest timber in Ontario, this tax takes two forms: stumpage fees, which are royalties for the trees that are cut down; and area charges which are rents for the use of Crown land. The stumpage fees range from 54¢ to $7.03 a cubic metre, depending on the type of trees harvested, while the area charge in 1992 is currently set at $47 per square kilometre. Estimated revenue for 1990-91 was $84 million.

Commercial Concentration Tax: This tax applies only to the Greater Toronto Area, and was introduced to help fund the five-year $2 billion Transportation Capital Program. The CCT is set at $1 per square foot per year, and is levied on owners of commercial buildings and parking lots, and now brings in about $100 million a year.

FOR DISCUSSION:

Although the last nine taxes combined yield only about 30% of the province's tax revenue and individually are considered fairly minor taxes compared to the Big Three–income tax, sales tax and property tax–they each have potentially major impacts on the industries or sectors to which they're applied.

Concerns and complaints have therefore emerged about many of these "minor" taxes. For example, the employer health tax is claimed to be unfair because it only applies to wages and salaries paid to employees and not other forms of income.

The gas and diesel fuel taxes have been blamed for drops in gas station sales near the American border. The trucking industry also charges that higher diesel fuel prices in Ontario make it very hard for provincial truckers to compete with their U.S. rivals. Differences in gas prices between communities in the northern and southern regions of the province have also been targeted for criticism.

Smokers and non-smokers continue to dispute the fairness and effectiveness of the tobacco tax. The 1,860,000 Ontarians who smoke object to the higher cost of cigarettes by the tax, but health groups argue that Ontario's tobacco tax is the second lowest of all the provinces and should therefore be raised even higher.

Canadian tobacco manufacturers are protesting the widening gap between prices in Ontario and those in bordering U.S. states. Loss of sales to these states, and increases in cigarette smuggling across the border, are also cited.

In the Toronto area, the commercial concentration tax has been blamed for increases in the Toronto Transit Commission's parking rates, and hence for discouraging use of the TTC. Hotel owners claim the Commercial Concentration Tax (CCT) makes them less competitive with hotels in other cities, especially in attracting conventions to Toronto. Municipal governments within the Toronto area also complain that this is essentially a property tax, and as such, taps a revenue source that should belong to local government.

There are more than 156,000 kilometres of roads and highways in Ontario. The construction and maintenance of these roads is paid for from provincial and municipal tax dollars. In 1990, about $9.3 million was spent on this service.

QUESTIONS:

Should the employer health tax be expanded to cover investors and the self-employed?

Should taxes on gasoline and diesel fuel be lowered to help the trucking industry and gas station operators near the American border?

Should the tobacco tax be raised or reduced? Does it really discourage people from smoking? Should the revenues be earmarked for health care?

Is it fair to impose a tax - the commercial concentration tax - on business in only one metropolitan area, and, if so, should that tax take the form of a property tax that is normally collected only by municipal governments?

Should most of these minor taxes be integrated with compatible major taxes so as to reduce their number and the accompanying duplication and extra paper-work?

AFTERWORD

The explanation of Ontario's tax system in this booklet only covers the system's main features. The commission wants people to be as informed as possible about the province's tax system. That makes sense. If we know how the present system works and what its strong and weak points are, we'll be more likely to come up with ideas and proposals for change that are workable.

Opinion polls verify what most of us already suspected. People are unhappy with a tax system they don't understand; that isn't easily accessible to them; that doesn't respond to their complaints; that seems to treat some better than others; and that doesn't let them take part in tax policy decisions. Many feel they are overtaxed.

Most people – even those of us with only a vague idea of how the tax system operates – understand that it can't be studied in isolation. We know it has to be linked with the province's broader social and economic goals. We know, too, that there has to be a balance between taxing enough to pay for needed services and social progress, on the one hand, and on the other, keeping taxes low enough to encourage economic activity and industrial growth.

Above all, we'd like to have a tax system that is demonstrably fair, that is open, accountable, flexible, democratic – and a whole lot simpler.

Clearly, the Fair Tax Commission faces a big challenge. But it can be met – if you work with the commission to help.

The first step toward getting involved in this process is to arm yourself with the most useful facts and figures. Reading through this booklet is a good beginning. Using it as an aid for group discussions would be an excellent follow-up.

Everyone – individually, with our friends, associates or co-workers or as represented by an organization – will be given an opportunity to present their views to the commission and/or its working groups. Don't let the opportunity slip away.

The title of this booklet says it all. What the commission has embarked upon is indeed Searching for Fairness. It's a quest that most of us would agree is important. Its chances of succeeding, however, will be decided by the extent to which you accept the commission's invitation to join in that search.

GLOSSARY

ability to pay - A principle of tax fairness that requires that all taxpayers make an equal sacrifice of well-being in paying tax. This implies that people who have the same capacity to pay taxes should pay the same amount of tax [horizontal equity]. Taken together with the assumption that the well-being represented by a dollar of income declines as income increases, this principle also provides the philosophical basis for progressive taxation [vertical equity].

assessment - When applied to municipal property taxation, refers to the determination of the value of property for municipal tax purposes.

Basic Federal Tax - The amount of federal income tax determined after allowing for "non-refundable credits" [based on personal exemptions, charitable contributions etc.] that apply to both federal and provincial taxes but before deducting credits that apply only to federal taxes. Under Canada's federal-provincial income tax collection agreements, provincial tax is calculated as a percentage of basic federal tax.

benefit taxation - Taxation based on the amount of benefit that the taxpayer derives from the public services paid for by the tax. It is an alternative principle of taxation to ability to pay, and provides the conceptual basis for such taxes as tolls and licences.

capital expenditures - Expenditures on assets such as machinery that are used over a number of years rather than being used up in the production process in a single tax year.

capital gains [losses] - Profits [losses] made by an investor from disposing of an asset (stock, bond, house, etc.) for more [less] than the price that was paid for it. Capital gains are treated differently in the income tax system than income earned from employment or other business income in that all capital gains are at least partially exempt from tax and some capital gains are completely exempt from tax.

capital tax - Generally, any tax on capital or wealth. In Ontario, a "paid-up capital" tax is levied on corporations. The tax is levied as a percentage of the "paid up capital" [book value of assets after subtracting current accounts payable]

Carter Commission - The path-breaking federal royal commission on taxation. The commission was chaired by Kenneth Carter and reported in 1967. It is noted for the idea that all income should be taxed in exactly the same way–the oft-quoted maxim that "a buck is a buck is a buck".

consumption taxes - Taxes placed on the things (goods and services) we buy. Sales taxes like the GST and Ontario's retail sales tax are general consumption taxes that apply to a broad range of goods and services. Some economists have suggested that rather than taxing specific items consumed by individuals, consumption taxes should be levied on all income that is not saved.

corporate minimum tax - A tax designed to ensure that all profitable corporations pay a minimum amount of tax on their profits. Minimum taxes have been proposed as a response to the special provisions in the corporate tax system that make it possible for some profitable corporations to pay little or no corporate income tax.

deferred income tax - A tax liability that arises when the income that a business shows on its tax return is less than it would have been had the same accounting principles been used in the tax return as were used for the business' own financial reporting. For example, for many types of assets, the income tax system allows taxpayers to depreciate or write off the asset at a faster rate for tax purposes than they do in their own financial records. Corporations reflect the difference in these two depreciation amounts as changes in the reported amount of deferred income tax.

depreciation - The loss in the value of an asset over time. Both tax rules and accounting principles recognize the fact that assets that are used to produce a good or service decline in value and therefore are in effect "used up" in the production process. That loss in value is subtracted from the operating income of a business in determining both financial statement (book) profits and taxable income. For most types of assets, the tax rules allow asset values to be depreciated more rapidly than is normally the case for accounting purposes.

direct tax - A tax that is assessed and collected from the persons who are intended to bear it, (e.g. personal income taxes). A tax is classified as "direct" or "indirect" based on the administrative arrangements for its collection. An indirect tax is one that is levied on a particular person with the intention that it should be passed on to someone else. Examples of indirect taxes include taxes levied at the manufacturing or wholesale level that are simply passed on to ultimate consumers. (see tax incidence)

dividend - A distribution of earnings to shareholders of a corporation.

dividend tax credit - An income tax credit based on a percentage of dividend income received from Canadian corporations. This is described by the federal government as an incentive to Canadians to hold shares in Canadian corporations. It also has the effect of partially integrating the personal income tax and corporate income tax. The credit allowed to shareholders in Canadian corporations represents the tax paid on that dividend by the corporation concerned. The integration of the two systems is not complete. Because the dividend tax credit is a fixed percentage of the dividend payment, shareholders receive credits whether or not the corporation that paid the dividend actually paid any tax on it.

employer health tax - A tax on payrolls of businesses in Ontario. It was introduced as a replacement for the Ontario Health Insurance Plan premium and raises enough revenue to pay about 17 per cent of the cost of medicare.

exemption or exempt income - Any income that is excluded from the definition of income in the tax system. For example, capital gains on principal residences are exempt from income tax. An exemption is distinguished from a deduction which is normally based on an expenditure and reduces the amount of a person's or a corporation's income on which tax is calculated.

federal manufacturers' sales tax (MST) - An indirect tax (13% when it was repealed) on manufactured goods that was levied at the manufacturer's level by the federal government before it was replaced by the GST in January 1991.

goods and services tax (GST) - A general seven per cent sales tax levied by the federal government on almost all goods and services. Although the GST is paid at every stage of the production process, businesses receive a credit for tax paid on inputs. As a result, the GST is a tax only on final consumption.

Income Tax Collection Agreements - The federal-provincial agreements under which provincial income taxes are collected by the federal government. Personal income tax in Canada is harmonized through tax collection agreements in which provinces agree to levy taxes as a percentage of the basic federal tax and in return the federal government collects the tax on behalf of the provinces. At present, all provinces except for Quebec are covered by personal income tax sharing agreements. Quebec, Ontario and Alberta are not part of the agreement when it comes to corporate income tax.

land transfer tax - Tax on the sale of land or real estate paid to the provincial government as a percentage of the selling price.

market value assessment - Method for assessing land and buildings for property tax. Assessment is based on the fair market value of the property using a standardized measurement system.

mill rate [or property tax rate] - The tax rate levied by a municipality or school board on the assessed value of a property. Technically, the mill rate is the number of dollars in tax for each $1,000 of assessed value.

net income (corporate) - The amount of income after all expenses - including all taxes, depreciation and interest on long-term debt - have been deducted.

progressive taxation - A system of tax in which the marginal tax rate increases as a taxpayer's capacity to pay tax increases. Progressive income tax systems are designed to levy a higher proportion of tax on high income taxpayers than on low income taxpayers.

property tax - A tax on the assessed value of land and buildings levied by municipal governments and used to fund municipal services, police, education and other services.

provincial personal income tax - The personal income tax paid to the provincial government. Under the current tax collection agreements between provinces and the federal government, provincial tax is calculated as a percentage of basic federal tax (53% in Ontario).

retail sales tax - A provincial tax of 8% paid by Ontario residents on the value of retail sales. Expenditures on food, medicine and energy and most services are currently exempt.

Smith Committee - The last major tax reform study conducted in Ontario in the 1960s. The committee was chaired by Lancelot J. Smith.

subsidy - A direct or indirect payment from the government to a corporation or individual which is tied to particular kinds of economic behaviour (e.g. tax credits for research and development).

surtax - An additional tax in which the amount of tax is based on tax payable in accordance with the normal tax rules. In Ontario, there is a surtax of 14% on Ontario income tax above $10,000. This means, for example, that a taxpayer who pays Ontario tax of $11,000, would pay a surtax of $140. This surtax applies to individuals with taxable incomes above approximately $85,000.

tax base - The amount/activity on which a tax is levied. For example, the retail sales tax base is the retail price of a taxable good or service; the personal income tax base is the total of all amounts that the tax system recognizes as income.

tax bracket - the range of income in which a particular rate of tax applies.

tax credit - An amount that may be deducted from tax in determining the amount of tax payable. The federal Income Tax Act allows certain credits to reduce the income tax owed by a person or company. The tax payable is reduced by the amount of the credit. Ontario also provides credits of its own that may reduce the amount of tax payable to the province.

non-refundable credit - A tax credit that can only be used to reduce a taxpayer's tax liability to zero, but cannot result in a refund to a taxpayer whose tax payable is calculated as less than zero.

refundable credit - A tax credit that is payable to a taxpayer regardless of whether (s)he is required to pay any tax.

tax deductions - Deductions are amounts that taxpayers are allowed to subtract from their taxable income before individual or corporate tax liabilities are determined.

tax equity - The term for tax fairness used by tax technicians. Commonly applied principles of tax equity include horizontal equity and vertical equity. Horizontal equity requires that taxpayers in similar economic circumstances should pay the same amount of tax. Vertical equity requires that taxpayers with greater capacity to pay tax should pay more.

tax expenditures - A term used to describe the various tax provisions used to reduce the amount of tax a taxpayer owes. Tax expenditures include revenue lost from creating special categories of exempt income, and categories of income taxed at preferential rates, as well as deductions from income permitted before tax is calculated, and tax credits. Otherwise referred to as "tax preferences".

tax incidence - Who actually pays a tax. When a tax is imposed on a person or company, it is often possible to shift the burden to someone else. For example, if a manufacturer is subjected to a new sales tax, it may be passed on to the consumer by increasing the price of the product being sold, to workers in the form of lower wages or to shareholders in the form of reduced dividend income.

tax mix - The proportion of revenue raised from various tax sources.

taxable income - The amount on which the income tax calculation is based. It is determined by subtracting allowable deductions from the tax base.

tax rates - average tax rate vs marginal tax rate

average tax rate - the total income tax payments as a proportion of income.

marginal tax rate - the rate of tax on an incremental unit of income. For example, the top marginal tax rate of 44% means that taxpayers with a taxable income over $60,000 pay 44 cents in tax for each additional dollar earned.

tax rates - nominal tax rate vs effective tax rate

nominal tax rate - the rate of tax that appears in the tax statute or which would apply if all income were taxed and no deductions or credits applied.

effective tax rate - the rate of tax that actually applies to a taxpayer after exemptions, deductions and credits are applied.

transfer payment - A payment made by a government to an individual or business or to another level of government (e.g. family allowance, old age pension, welfare payment).

user-pay tax - A tax, toll or levy on the user of a government service (e.g. licences, tolls on bridges or highways).

value-added tax - A tax similar in effect to a sales tax but levied only on the value added at each stage of the production/distribution process. Value added taxes are collected in practice by requiring that tax be charged by the seller on every transaction at the full value and allowing tax paid by the seller to be deducted. Also referred to as a multi-stage tax. The GST is based on the concept of a value added tax.

wealth tax - A tax on individual wealth. Wealth taxes generally take one of two forms – an annual net wealth tax or a wealth transfer tax. Annual net wealth taxes normally apply very low rates to an individual's total wealth. Wealth transfer taxes are levied on estates or inheritances and on the donors or recipients of gifts. Canada and Australia are the only major industrial countries that do not levy a wealth tax in any form.

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ISBN: 0-9695929-0-6
2/92/15M